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*Managing Director and Principal*

August 1, 2008

Ms. Anne Stausboll  
Interim Chief Investment Officer  
California Public Employees' Retirement System  
400 Q Street  
Sacramento, CA 95814

Re: Corporate Governance Investments Program Review

Dear Anne,

You requested Staff's review of the Corporate Governance Investments Program. We feel that Staff has accurately described the program and many of the issues that it confronts on a regular basis.

### **Discussion**

Staff has presented this review in response to a request from the Investment Committee. Wilshire has been working on its own review of the Corporate Governance Investments Program, the results of which are scheduled to be presented at the October meeting. To that end, Wilshire has spent much of the summer meeting in person with CalPERS current external Corporate Governance Investments managers, both domestically and abroad. In addition to regular conference calls which are focused on the performance of the portfolios and the progress of each firm's engagements, these meetings are focused on gathering updates regarding each firm and its strategic plans, changes to or refinements in the overall investment or engagement philosophy, and an overall assessment of how CalPERS portfolio is constructed.

While the long term performance of the Program has been quite good, the recent performance has been difficult. Wilshire notes three factors in play. First, as Staff notes, there is a de facto value bias in every corporate governance strategy. Since the underlying philosophy of all activist strategies is to buy undervalued or misunderstood companies and engage with the company to unlock the value in the markets, growth stocks tend to have no place in a manager's portfolio. Second, there is a de facto small cap bias. This is a result of the same factors that drive the value bias – namely, undervalued companies are definitionally smaller from a market cap stand point than that same company would be if it were fairly valued by the market. In addition, corporate governance investments may be more effective in smaller companies, as access to top management may be more easily garnered and opposition to an engagement is likely to

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be less significant.. Last, the returns driven by the engagement process are lumpy. An average engagement lasts between 2 and 3 years. Over time, the returns generated by activism have demonstrably added value. However, there have been and will continue to be periods of time where particular managers will meaningfully underperform their respective benchmarks.

Notably, the Corporate Governance Investments Program is experiencing fairly rapid growth as Staff expands the program geographically to include emerging markets. Over the past 6-12 months, Wilshire has conducted on-site due diligence on at least 5 strategies from existing and new providers (Wilshire is not the only consultant engaged to conduct such due diligence). As CalPERS continues to develop the portfolio, due consideration must be given to the appropriate geographic weightings, balancing diversification with opportunity.

### **Conclusion**

Wilshire believes Staff's information item is an accurate reflection of the Corporate Governance Investments Program and fairly presents the Program's performance and some of the challenges CalPERS faces with an activist strategy. Wilshire is conducting an independent review of the Program, which will be presented in the very near future.

If you have any questions or comments, please let me know.

Sincerely,

A handwritten signature in black ink, appearing to read "Anne Stausboll". The signature is fluid and cursive, with the first name "Anne" written in a larger, more prominent script than the last name "Stausboll".